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Report of the Advisory Committee on Administrative and Budgetary Questions on the report on UNDP strategic cost management and implications for cost recovery*

1. The Advisory Committee on Administrative and Budgetary Questions has considered the report of the Administrator of UNDP on UNDP strategic cost management and implications for cost recovery (DP/2004/35). During its consideration of the matter, the Advisory Committee met with representatives of the Administrator.

2. The report of the Administrator is submitted pursuant to Executive Board decision 2003/22, paragraph 6, requesting "a report on UNDP cost recovery policy to [be submitted to] the Executive Board at its second regular session in September 2004, including the methodology in calculating the rates as well as an update on the adequacy of provisional rates, options for transparent reporting on income from cost recovery, including the possibility of including this income in calculating the next biennial support budget, as well as a comparison with the practice of the other funds and programmes within the United Nations Development Group (UNDG)."

3. The report provides a more detailed picture of UNDP cost recovery policy, including the subject of harmonization of cost recovery principles and practices in UNDG funds and programmes. As such, it is an update of UNDP cost recovery as originally presented in the context of the UNDP budget estimates for the biennium 2004-2005 (DP/2003/28). According to the Administrator, the report does not include any proposal for change or major departure from the current cost recovery policy.

4. In its decision 2003/22, paragraph 5, the Executive Board endorsed, as a provisional arrangement, the approach for cost recovery as contained in paragraphs 130 to 134 of the UNDP budget estimates for the biennium 2004-2005. As indicated in paragraph 132 of document DP/2003/28, over the biennium 2002-2003, the cost

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recovery methodology moved from a 3 per cent across-the-board rate to a 3 to 5 per cent rate range. This was increased to a revised range of 5 to 7 per cent on third-party cost sharing and trust funds for 2004-2005. In the case of local government cost sharing, the cost recovery rate would average 3 per cent for 2004-2005.

5. The Committee was informed that cost recovery for UNDP services continues to revolve around three main areas: (a) services to other resource-funded programmes; (b) services to the United Nations system at the country level; and (c) services to some United Nations entities at the headquarters level. Document DP/2004/35 deals primarily with the cost recovery for support services to programmes funded from other resources. In developing the cost recovery policy, UNDP has categorized the services provided as general management support services, including general oversight, and implementation support services; the latter relates to transactional services provided mainly by country offices directly to programmes and projects (see DP/2003/28, paragraph 131 and DP/2004/35, paragraphs 36 to 49 and annex D).

6. A critical element in UNDP cost recovery policy is harmonization with other United Nations organizations. The Committee was informed that, in a series of meetings in the context of the High-level Committee on Management (HLCM), the executing agencies have agreed on a common definition of principles for the purpose of cost recovery (DP/2004/35, paragraph 10). Based on discussions led by the United Nations Educational, Scientific and Cultural Organization (UNESCO) in the United Nations Financial and Budget Network (a subsidiary body of the HLCM), the agencies have agreed that the objective of harmonization should not be a uniform programme support cost or recovery percentage for all United Nations organizations, fully recognizing that the agencies have different mandates, funding patterns, organizational and operational structures and therefore different cost structures. Moreover, agencies have agreed, in line with recommendations by the Joint Inspection Unit (JIU) (see JIU/REP/2002/3), to common key cost recovery principles that should allow organizations and donors to compare cost recovery practices across organizations. United Nations organizations have agreed on common definitions of cost categories, including various elements of direct costs, fixed and variable costs, and agreed that cost recovery would generally apply to variable indirect cost (see also paragraphs 11 to 17 of document DP/2004/35).

7. The Advisory Committee notes from annex C of document DP/2004/35 that the comparison of cost recovery practices in UNDG organizations is not meaningful, because the basis for the calculation of the indirect support rates is quite different for each organization. In the view of the Committee, all entities concerned need to follow the same template to achieve a meaningful comparison. United Nations funds and programmes should continue consultations for further harmonization of cost recovery principles, with the objective of clearly identifying common elements under each cost category and differences resulting from different mandates and operating modalities.

8. The Advisory Committee is aware that significant differences exist in the way United Nations organizations are funded, in the corresponding funding mechanisms for the administrative and programme support costs and in the methods for cost recovery for support services provided to activities funded from earmarked (other) resources. The Committee agrees with the view that the objective of cost recovery harmonization is not a uniform programme support cost or cost recovery percentage

for all United Nations organizations. It is still possible, in the opinion of the Committee, to standardize most cost recovery rates under commonly agreed cost categories or projects and increase transparency on methods used for calculation of cost recovery rates. The Committee has observed in the past that each service must be paid for by clients, including administrative and management costs, and that an accurate identification of costs to deliver services becomes essential to be able to request a fair reimbursement (see, for example, DP/2001/24, paragraph 5).

9. The Committee was informed that the UNDP cost recovery policy also relates to the concept of a base structure. As part of its biennial support budget for 2004-2005, UNDP introduced the concept of base structure for country offices and headquarters. The base structure is defined as those costs that constitute the minimum critical mass of staff capacity and relating operating costs. These are explained in paragraphs 31 to 35 of document DP/2004/35. The base structure is fully funded from regular resources under the UNDP biennial support budget. Costs over and above the base structure are shared proportionally between regular and other resources (see also DP/2003/28, paragraphs 60 and 83). The Committee notes that, in the context of harmonized cost definitions, the UNDP base structure is identified as a fixed indirect cost and, given the fact that this cost is unaffected by the volume of other resources managed by UNDP, it is not considered subject to cost recovery (see DP/2004/35, paragraph 21). UNDP considers the costs for all management and operational services outside the base structure as variable indirect costs. These fluctuate as a function of the volume of resources managed by UNDP (DP/2004/35, paragraph 22).

10. General management support (GMS) functions, which UNDP has to perform before, after and during the life of a programme, where the cost cannot be linked to individual programme activities, include those listed in paragraph 37 of document DP/2004/35. The structures necessary to provide these functions are a reflection of the volume of resources managed by UNDP. In order to recover the variable indirect costs incurred, each source of funds is charged its proportional share of these variable indirect costs. UNDP will continue to apply the recovery rates endorsed by the Executive Board in decision 2003/22. A general management fee for variable indirect costs, set in the range of 5 to 7 per cent is charged to all programmes funded from other resources by donors for third-party cost sharing and trust funds (DP/2004/35, paragraph 41 and annex C).

11. GMS fees for variable indirect costs for programmes funded from other resources by recipient governments for their own programmes, under the cost-sharing funding modality, has been set at an average of 3 per cent measured over the country-specific programme portfolio. In most cases, under this arrangement, the local government is the single financing source for its own programme portfolio in which a large portion of the project design has been done by institutions other than UNDP (see DP/2004/35, paragraphs 43 to 44 and annex C).

12. As noted above, UNDP also provides services during programme implementation, either to programme country governments in support of national execution, or to other United Nations organizations in the implementation of their own programmes (see DP/2004/35, paragraphs 45 to 46 and annex D). The Advisory Committee notes that UNDP assesses a fee for these implementation support services, which covers the full cost and is categorized as direct cost. UNDP has prepared a schedule, referred to as a Universal Price List, with these average prices

for each standard transaction for each of the services (DP/2004/35, paragraphs 47 to 49 and annex D).

13. Upon enquiry, the Advisory Committee was informed that UNDP had introduced a new information technology system (an enterprise resource planning system named "Atlas"), starting in January 2004, to support the organization in attaining disaggregate analysis of recovery income and a better formulation of requisite structures, which was impaired in the past owing to system limitations. The ultimate UNDP objective is the true attribution of all costs to the proper fund source. The delineation between fixed and variable indirect costs will be reviewed and further refined, taking into consideration structural changes resulting from the implementation of the Atlas system, and will be presented to the Executive Board in the context of the biennial support budget for 2006-2007. The Committee was also informed that the Atlas system was being implemented in UNFPA and UNOPS.

14. The Advisory Committee notes the report of the Administrator and the progress made by United Nations organizations on the subject of cost recovery harmonization. The Committee encourages all United Nations organizations concerned to continue their work in this regard, taking into account the specific issues raised by the Committee in the preceding paragraphs. The objective is to arrive at a fair balance between the need to ensure that core resources do not unduly subsidize project activities while at the same time ensuring that resources available for projects are not unduly diminished. The Committee intends to monitor the progress made in the context of UNDP biennial support budget for the period 2006-2007, and trust that a means can be found to increase transparency in the setting of cost recovery rates.